

# **REPORT OF THE AUDITOR-GENERAL TO THE KWAZULU-NATAL PROVINCIAL LEGISLATURE AND THE COUNCIL ON THE FINANCIAL STATEMENTS AND PERFORMANCE INFORMATION OF NQUTHU MUNICIPALITY FOR THE YEAR ENDED 30 JUNE 2009**

## **REPORT ON THE FINANCIAL STATEMENTS**

### **Introduction**

1. I was engaged to audit the accompanying financial statements of the Nquthu Municipality which comprise the balance sheet as at 30 June 2009, and the income statement and the cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes, as set out on pages XX to XX.

### **The accounting officer's responsibility for the financial statements**

2. The accounting officer is responsible for the preparation of these financial statements in accordance with the entity specific basis of accounting, as set out in accounting policy note 1 and in the manner required by the Local Government: Municipal Finance Management Act, 2003 (Act No. 56 of 2003) (MFMA) and for such internal control as the accounting officer determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

### **The Auditor-General's responsibility**

3. As required by section 188 of the Constitution of the Republic of South Africa, 1996, read with section 4 of the Public Audit Act, 2004 (Act No. 25 of 2004) (PAA) and section 126(3) of the MFMA, my responsibility is to express an opinion on these financial statements based on conducting the audit in accordance with the International Standards on Auditing and *General Notice 616 of 2008*, issued in *Government Gazette No. 31057 of 15 May 2008*. Because of the matters described in the Basis for disclaimer of opinion paragraphs, I was not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion.

### **Basis for disclaimer of opinion**

#### **Property, plant and equipment**

4. Disclosed in note 3 to the financial statements is property, plant and equipment to the value of R19,28 million. Our audit indicated the following material deficiencies in the fixed asset management systems :-
  - Fixed assets disclosed in the fixed asset register differ from the amounts reflected on the supporting documentation by R2.1 million.
  - Assets to the value of R25, 84 million were not supported by any documentation.
  - Assets valued at R1, 1 million recorded on the fixed asset register could not be physically located.
  - 9 assets were identified which could not be traced to the asset register.

- Capital projects of R4, 88 million completed during the year were not capitalised to assets.
- Assets of R2, 43 million that were not in working condition were not written off.

The municipality's records did not permit the application of alternative audit procedures. Consequently, I was unable to obtain sufficient appropriate audit evidence to confirm the existence, completeness, valuation and the rights of assets of R19,28 million (2008: R6,68 million)

5. Furthermore the external loans of R4, 98 million recorded in appendix B does not agree to the net fixed assets of R19, 28 million recorded in appendix C. In the absence of an accurate and complete asset register, the completeness and valuation of the funding entries and balances recorded under Loans Redeemed and Other Capital Receipts of R52,34 million (2008: R27,77 million) could not be substantiated.

## Revenue

6. The municipality did not have a proper billing system in place. The following material deficiencies were identified from rates assessments income, sale of electricity and other service charges:-

- The amounts recorded in the financial statements did not agree to the manual billing schedule. A total difference of R1, 3 million was noted.
- Twenty four properties were identified where consumers were billed for rates and refuse twice.
- Properties were not correctly classified between domestic and commercial properties resulting in incorrect rates and charges being applied.
- Incorrect electricity billing of R596 000 was identified which resulted in income from the sale of electricity being overstated by this amount.
- Receipts of R333 956 relating to prior year electricity charges were incorrectly accounted for as income in the year under review.

The municipality's records did not permit the application of alternative audit procedures. Consequently, I was unable to obtain sufficient appropriate audit evidence to confirm the accuracy and completeness of income of R6, 40 million (2008: R2, 91 million).

## Receivables

7. An effective debtors billing system was not maintained and the following weaknesses identified indicate material deficiencies in the management of debtors at the municipality:-

- Documentation was not made available to support the opening debtors' balance of R5, 89 million.
- The debtors' ledger, debtors' reconciliations and debtors' age analysis were not made available for inspection during the audit. Although a manual billing schedule was provided, significant weaknesses were identified with this schedule. (Refer to paragraph 6 above).

- In the absence of the debtor's age analysis and proper records or documentation supporting the opening balance of R5,8 million I was unable to carry out all procedures necessary to assess the adequacy of the provision for bad debts of R5 million.

The municipality's records did not permit the application of alternative audit procedures. Consequently, I was unable to obtain sufficient appropriate evidence to confirm the existence, valuation of and the municipality's rights to the debtors balance of R7,13 million (2008: R5,89 million).

### **Employee costs**

8. Salaries, wages and allowances disclosed in the annual financial statements differ from the amount recorded on the payroll system by R665 400. This was mainly due to an adjustment of R671 133 incorrectly processed to the general ledger. As a result employee costs are overstated and payables are understated by R671 133.
9. The prior year bonus payment of R688 549 was incorrectly processed to the salary control account. As a result accumulated surplus is overstated and the salary control account (payables) for the current year is overstated by R688 549.
10. A provision was not made for bonuses due and payable to the employees of the municipality. As a result employee costs and the accumulated surplus are understated by R320 321 and provisions are understated by this amount.

### **Consumer deposits**

11. Disclosed in note 7 to the financial statements are consumer deposits with a nil value. I could not obtain sufficient appropriate audit evidence to substantiate the balance of R491 900 written off during the current year due to the fact that as reported in the prior year, a consumer deposit register detailing the properties and the consumers in respect of which deposits are held was not maintained. Consequently I was unable to confirm by alternative procedures the valuation, existence and completeness of the consumer deposit liability that should be disclosed in the financial statements.

### **Unauthorised expenditure**

12. The reserves of R6,38 million, representing unspent conditional grants, are only supported by cash and cash equivalent balances of R5,66 million resulting in unauthorised expenditure of R 720 000. The unauthorized expenditure has not been disclosed in accordance with section 125(2)(d) of the MFMA.

### **Irregular expenditure**

13. As reported in the prior year the value of private use of the official mayoral vehicle for the current year has not been recovered from the mayor. The non recovery of such expenditure amounts to irregular expenditure in terms of section 167(2) of the MFMA. In the absence of accurate information on the mileages and actual maintenance costs of this vehicle, I am unable to quantify the completeness and accuracy of irregular expenditure.

### **Distribution losses: Electricity**

14. The municipality does not have adequate processes to identify and manage material losses arising from the distribution of electricity and I could therefore not determine the extent of the loss at year end. As a result the municipality did not disclose the distribution losses in the financial statements in accordance with section 125(2)(d) of the MFMA.

### **Capital Commitments**

15. Capital commitments identified during the testing of capital projects have not been disclosed in the financial statements. In the absence of a proper contracts register the completeness of the obligations for the capital commitments could not be ascertained.

### **Corresponding figures**

16. In the prior period I issued a disclaimer of audit opinion on the financial statements. The matters that gave rise to the disclaimer of the audit opinion remain substantially unresolved; as a result, these misstatements have affected the fair presentation of the amounts disclosed in the current period. For matters that have been resolved, the related comparative amounts have not been adjusted. As a consequence the affected comparative amounts and opening balances for property, plant and equipment, debtors, revenue, expenditure, cash and cash equivalents, value added tax, government grants, creditors, consumer deposits and investments were also either misstated or could not be audited. The cash flow statement was not prepared for the prior year.

### **Disclaimer of opinion**

17. Because of the significance of the matters described in the Basis for disclaimer of opinion paragraphs, I have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion. Accordingly, I do not express an opinion on these financial statements.

### **Emphasis of matters**

I draw attention to the following matters on which I do not express a disclaimer of opinion:

### **Basis of Accounting**

18. The municipality's policy is to prepare financial statements on the entity specific basis of accounting, as set out in accounting policy note 1.

## **Going concern**

19. The 2008/2009 financial statements does not draw attention to doubts concerning the municipality's ability to discharge all its obligations in the normal course of business, in the foreseeable future. The doubts arise in view of the following:-

- Fund and reserve balances are not supported by cash and investments.
- The fixed assets of the municipality are not adequately insured.
- For the period under review, consumers were not billed on a monthly basis and this resulted in minimal recoveries of amounts due to the municipality thereby impacting negatively on the municipality's cash flows.
- The doubtful debts have not been fully provided for.

These conditions indicate the existence of an uncertainty which casts doubt on the municipality's ability to continue as a going concern.

## **OTHER MATTERS**

I draw attention to the following matters that relate to my responsibilities in the audit of the financial statements:

### **Material inconsistencies in information included in the annual report**

20. I have not obtained the other information included in the annual report and have not been able to identify any material inconsistencies with the financial statements.

### **Non Compliance with applicable legislation**

#### **Municipal Finance Management Act**

21. The municipality had not prepared and tabled an annual report with Council for the 2007/08 financial year as required by Section 121(1) and 127(2) of the MFMA.

22. Actual revenue and expenditure per vote for the preceding financial year is not reflected in the annual budget as required by section 17(1)(d)(ii) of the MFMA.

23. The mayor did not table the time schedule at least ten months before the start of the budget year outlining the key deadlines for preparation, tabling and approval of the budget as required by section 21(1)(b) of the MFMA.

24. The capital budget is incomplete as it does not reflect the projected capital expenditure for the next two financial years as required by section 16(3) of the MFMA.

25. Evidence that the budget was submitted to National Treasury in accordance with section 22(b)(i) of the MFMA could not be obtained.

26. The municipality did not calculate its revenue on a monthly basis, nor did it have an, accounting and information system for the management of revenue and did not reconcile all revenue received at least on a weekly basis as required by section 64(2)(b), (e) and (h) of the MFMA.

27. The municipality did not ensure the participation of only pre-qualified persons for the bidding process, as not all suppliers were registered on the approved supplier database as required in terms of section 112(1)(f) of the MFMA.
28. The accounting officer of the municipality did not take all reasonable steps to ensure that contracts are properly enforced as required by section 116 (2)(a) of the MFMA, as not all contracts awarded, were signed by the accounting officer.

### **Municipal Systems Act**

29. The staff establishment was not approved and the municipality did not establish a process or mechanism to evaluate the staff establishment on a regular basis as required by section 66 of the Local Government: Municipal Systems Act, 2000 (Act No. 32 of 2000) (MSA)

### **Local Authorities Ordinance**

30. The municipality did not obtain exemption for the contribution to the capital development fund of not less than 3% of the annual revenue accruing to the rates and general service as required by section 103(9)(b)(i) of the Local Authorities Ordinance, 1974 (No.25 of 1974).

### **Governance framework**

31. The governance principles that impact the auditor's opinion on the financial statements are related to the responsibilities and practices exercised by the accounting officer and executive management and are reflected in the internal control deficiencies and key governance responsibilities addressed below:

### **Internal control deficiencies**

32. Section 62(1)(c)(i) of the MFMA states that the accounting officer must ensure that the municipality has and maintains effective, efficient and transparent systems of financial and risk management and internal control. The table below depicts the root causes that gave rise to the deficiencies in the system of internal control, which led to the disclaimer of opinion. The root causes are categorised according to five components of an effective system of internal control. (The number listed per component can be followed with the legend below the table.) In some instances deficiencies exist in more than one internal control component.

| Par. no. | Basis for disclaimer of opinion | CE | RA | CA    | IC | M |
|----------|---------------------------------|----|----|-------|----|---|
| 4, 5.    | Property, plant and equipment   |    |    | 5,6   |    | 1 |
| 6.       | Revenue                         | 5  |    | 6     | 1  |   |
| 7.       | Receivables                     | 5  |    | 6     | 1  |   |
| 8,9,10.  | Employee costs                  |    |    | 3,5,6 | 1  | 1 |
| 11.      | Consumer deposits               |    |    | 6     |    |   |
| 12.      | Unauthorised expenditure        |    |    | 5     |    |   |
| 13.      | Irregular expenditure           |    |    | 6     |    | 1 |
| 15.      | Capital commitments             |    |    | 5     |    |   |

|     |                       |  |  |   |  |  |
|-----|-----------------------|--|--|---|--|--|
| 14. | Distribution losses   |  |  | 5 |  |  |
| 16. | Corresponding figures |  |  | 5 |  |  |

33. The accounting officer has not established an adequate system of internal controls; as a result significant deficiencies relating to asset management, completeness and accuracy of revenue, the existence and valuation of debtors and the accuracy and completeness of employee costs, consumers deposits , unauthorised and irregular expenditure as well as material losses and corresponding figures were not timeously addressed.

| <b>Legend</b>   |   |
|---|---|
| <b>CE = Control environment</b>   |   |
| The organisational structure does not address areas of responsibility and lines of reporting to support effective control over financial reporting.       | 1 |
| Management and staff are not assigned appropriate levels of authority and responsibility to facilitate control over financial reporting.                  | 2 |
| Human resource policies do not facilitate effective recruitment and training, disciplining and supervision of personnel.                                  | 3 |
| Integrity and ethical values have not been developed and are not understood to set the standard for financial reporting.                                  | 4 |
| The accounting officer/accounting authority does not exercise oversight responsibility over financial reporting and internal control.                     | 5 |
| Management's philosophy and operating style do not promote effective control over financial reporting.  | 6 |
| The entity does not have individuals competent in financial reporting and related matters.  | 7 |
| <b>RA = Risk assessment</b>   |   |
| Management has not specified financial reporting objectives to enable the identification of risks to reliable financial reporting.                        | 1 |
| The entity does not identify risks to the achievement of financial reporting objectives.  | 2 |
| The entity does not analyse the likelihood and impact of the risks identified.  | 3 |
| The entity does not determine a risk strategy/action plan to manage identified risks.   | 4 |
| The potential for material misstatement due to fraud is not considered.   | 5 |
| <b>CA = Control activities</b>  |   |
| There is inadequate segregation of duties to prevent fraudulent data and asset misappropriation.  | 1 |
| General information technology controls have not been designed to maintain the integrity of the information system and the security of the data.          | 2 |
| Manual or automated controls are not designed to ensure that the transactions have occurred, are authorised, and are completely and accurately processed. | 3 |
| Actions are not taken to address risks to the achievement of financial reporting objectives.  | 4 |
| Control activities are not selected and developed to mitigate risks over financial reporting.   | 5 |
| Policies and procedures related to financial reporting are not established and communicated.  | 6 |
| Realistic targets are not set for financial performance measures, which are in turn not linked to an effective reward system.                             | 7 |
| <b>IC = Information and communication</b>   |   |
| Pertinent information is not identified and captured in a form and time frame to support financial reporting.   | 1 |
| Information required to implement internal control is not available to personnel to enable internal control responsibilities.                             | 2 |
| Communications do not enable and support the understanding and execution of internal control processes and responsibilities by personnel.                 | 3 |
| <b>M = Monitoring</b>   |   |
| Ongoing monitoring and supervision are not undertaken to enable an assessment of the  | 1 |

|  |   |
|--|---|
| effectiveness of internal control over financial reporting.  |   |
| Neither reviews by internal audit or the audit committee nor self-assessments are evident.                                       | 2 |
| Internal control deficiencies are not identified and communicated in a timely manner to allow for corrective action to be taken. | 3 |

### Key governance responsibilities

34. The MFMA tasks the accounting officer with a number of responsibilities concerning financial and risk management and internal control. Fundamental to achieving this is the implementation of key governance responsibilities, which I have assessed as follows:

| No.   | Matter   | Y                        | N                        |
|---|--|--------------------------|--------------------------|
| <b>Clear trail of supporting documentation that is easily available and provided in a timely manner</b>     |  |                          |                          |
| 1.  | No significant difficulties were experienced during the audit concerning delays or the availability of requested information.  |                          | <input type="checkbox"/> |
| <b>Quality of financial statements and related management information</b>                                   |  |                          |                          |
| 2.  | The financial statements were not subject to any material amendments resulting from the audit.   |                          | <input type="checkbox"/> |
| 3.  | The annual report was submitted for consideration prior to the tabling of the auditor's report.  |                          | <input type="checkbox"/> |
| <b>Timeliness of financial statements and management information</b>  |  |                          |                          |
| 4.  | The annual financial statements were submitted for auditing as per the legislated deadlines section 126 of the MFMA.   | <input type="checkbox"/> |                          |
| <b>Availability of key officials during audit</b>   |  |                          |                          |
| 5.  | Key officials were available throughout the audit process.   | <input type="checkbox"/> |                          |
| <b>Development and compliance with risk management, effective internal control and governance practices</b> |  |                          |                          |
| 6.  | Audit committee  |                          |                          |
|   | <ul style="list-style-type: none"> <li>The municipality had an audit committee in operation throughout the financial year.</li> </ul>  |                          | <input type="checkbox"/> |
|   | <ul style="list-style-type: none"> <li>The audit committee operates in accordance with approved, written terms of reference.</li> </ul>  | <input type="checkbox"/> |                          |
|   | <ul style="list-style-type: none"> <li>The audit committee substantially fulfilled its responsibilities for the year, as set out in section 166(2) of the MFMA.</li> </ul>         |                          | <input type="checkbox"/> |
| 7.  | Internal audit   |                          |                          |
|   | <ul style="list-style-type: none"> <li>The municipality had an internal audit function in operation throughout the financial year.</li> </ul>                                      | <input type="checkbox"/> |                          |
|   | <ul style="list-style-type: none"> <li>The internal audit function operates in terms of an approved internal audit plan.</li> </ul>  | <input type="checkbox"/> |                          |
|   | <ul style="list-style-type: none"> <li>The internal audit function substantially fulfilled its responsibilities for the year, as set out in section 165(2) of the MFMA.</li> </ul> |                          | <input type="checkbox"/> |
| 8.  | There are no significant deficiencies in the design and implementation of internal control in respect of financial and risk management.  |                          | <input type="checkbox"/> |
| 9.  | There are no significant deficiencies in the design and implementation of internal control in respect of compliance with applicable laws and regulations.                          |                          | <input type="checkbox"/> |



| No.  | Matter  | Y                        | N                        |
|--|---|--------------------------|--------------------------|
| 10.  | The information systems were appropriate to facilitate the preparation of the financial statements.   |                          | <input type="checkbox"/> |
| 11.  | A risk assessment was conducted on a regular basis and a risk management strategy, which includes a fraud prevention plan, is documented and used as set out in section 62(1)(c)(i) of the MFMA.  |                          | <input type="checkbox"/> |
| 12.  | Delegations of responsibility are in place, as set out in section 79 of the MFMA.   | <input type="checkbox"/> |                          |
| <b>Follow-up of audit findings</b>                                 |   |                          |                          |
| 13.  | The prior year audit findings have been substantially addressed.  |                          | <input type="checkbox"/> |
| 14.  | SCOPA resolutions have been substantially implemented.  | <input type="checkbox"/> |                          |
| <b>Issues relating to the reporting of performance information</b> |   |                          |                          |
| 15.  | The information systems were appropriate to facilitate the preparation of a performance report that is accurate and complete.   |                          | <input type="checkbox"/> |
| 16.  | Adequate control processes and procedures are designed and implemented to ensure the accuracy and completeness of reported performance information.   |                          | <input type="checkbox"/> |
| 17.  | A strategic plan was prepared and approved for the financial year under review for purposes of monitoring the performance in relation to the budget and delivery by the municipality against its mandate, predetermined objectives, outputs, indicators and targets [section 68 of the MFMA]. |                          | <input type="checkbox"/> |
| 18.  | There is a functioning performance management system and performance bonuses are only paid after proper assessment and approval by those charged with governance.   |                          | <input type="checkbox"/> |

35. Governance policies and practices do not operate effectively and appropriately. The municipality has not substantially complied with the key governance responsibilities. Weaknesses with respect to the risk management, audit committee, internal audit preparation of annual report, quality of financial statements, performance information and performance management needs to be addressed to improve adherence to the governance framework.

#### **Investigations**

36. A follow up forensic investigation relating to previous senior officials is currently being conducted. This investigation was still in progress at 30 June 2009.

### **REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS**

#### **Report on performance information**

37. I have reviewed the performance information as set out on pages XX to XX.

#### **The accounting officer's responsibility for the performance information**

38. In terms of section 121(3)(c) of the MFMA the annual report of a municipality must include the annual performance report of the municipality, prepared by the municipality in terms of section 46 of the MSA.

### **The Auditor-General's responsibility**

39. I conducted my engagement in accordance with section 13 of the PAA read with *General Notice 616 of 2008*, issued in *Government Gazette No. 31057 of 15 May 2008* and section 45 of the MSA.
40. In terms of the foregoing my engagement included performing procedures of a review nature to obtain sufficient appropriate evidence about the performance information and related systems, processes and procedures. The procedures selected depend on the auditor's judgement.
41. I believe that the evidence I have obtained is sufficient and appropriate to provide a basis for the review findings reported below.

### **Findings on performance information**

#### **Non-compliance with regulatory requirements**

##### **Lack of implementation of a performance management system**

42. The municipality did not implement a framework that describes and represents how the municipality's cycle and processes of performance planning, monitoring, measurement, review, reporting and improvement will be conducted, organised and managed, including determining the roles of the different role players, as required in terms of regulations 7 and 8 of the Municipal Planning and Performance Management Regulations, 2001.

##### **Reporting of performance information**

43. The performance report prepared by the municipality did not comply with the requirements of section 46(1) of the MSA as the following information was not reflected:-
- a) The annual performance reports do not cover all development priorities and objectives.
  - b) The annual performance reports do not cover key performance indicators such as:
    - Access to Basic Services and Infrastructure
    - Social Development
    - Municipal Transformation and Institutional Development
    - Good Governance and Community Participation
  - c) The performance of each external service provider
  - d) The comparison of the prior year performance targets and the current year's actual.
  - e) Measures to be taken to improve performance.

### **Existence and functioning of a performance audit committee**

44. The municipality did not appoint and budget for a performance audit committee, nor was the audit committee utilised as the performance audit committee, as required by regulation 14(2) of the Municipal Planning and Performance Management Regulations, 2001.

### **Internal auditing of performance measurements**

45. The internal auditors of the municipality did not audit the performance measurements on a continuous basis and did not submit quarterly reports on their audits to the municipal manager and the performance audit committee.

### **Usefulness and reliability of reported performance information**

46. The following criteria were used to assess the usefulness and reliability of the information on the municipality's performance with respect to the objectives in its integrated development plan:
- Consistency: Has the municipality reported on its performance with regard to its objectives, indicators and targets in its approved integrated development plan?
  - Relevance: Is the performance information as reflected in the indicators and targets clearly linked to the predetermined objectives and mandate. Is this specific and measurable, and is the time period or deadline for delivery specified?
  - Reliability: Can the reported performance information be traced back to the source data or documentation and is the reported performance information accurate and complete in relation to the source data or documentation?

The following audit finding relates to the above criteria:

### **Inconsistently reported performance information**

47. The consistency between the development priorities and objectives in the IDP and the budget could not be ascertained, as the budget did not contain development priorities and objectives.

### **Performance information not received in time**

48. An assessment could not be performed on the reliability of the reported performance information for Technical Services division, since the information was not received in time for audit purposes.

## APPRECIATION

49. The assistance rendered by the staff of the Nquthu Municipality during the audit is sincerely appreciated.

Pietermaritzburg

30 November 2009



AUDITOR - GENERAL  
SOUTH AFRICA

*Auditing to build public confidence*

FINAL DRAFT